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C O N F I D E N T I A L ASUNCION 000747

SIPDIS

PASS TO NSC DFISK, STATE FOR WHA/BSC MDRUCKER, BFRIEDMAN  
AND MDASCHBACH, H/CTO DRICH

E.O. 12958: DECL: 10/08/2028  
TAGS: PREL ECON PGOV SNAR PA  
SUBJECT: SCENE-SETTER FOR CODEL ENGEL TO PARAGUAY

Classified By: Deputy Chief of Mission Michael J. Fitzpatrick for reasons 1.4 (b) and (d).

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SUMMARY  
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¶11. (C) Embassy Asuncion warmly welcomes Codel Engel November 11-13. President Fernando Lugo's administration represents the first break in the Colorado Party's 61-year streak in power; as such, it is shaking the foundations of Paraguayan society. Just on the heels of President Lugo's October 27 meeting with President Bush in Washington, your visit offers the United States an opportunity to reaffirm its interest in Paraguay, particularly on trade issues. Lugo's challenges are many: An inexperienced team, exceedingly high expectations for change, endemic corruption, weak institutions, a divided Congress, and meddling by Venezuelan President Hugo Chavez. Lugo must generate jobs and promote economic development while downsizing a bloated state and tackling social and security issues of key concern to his constituents. Lugo's top goals are fighting corruption and the underground economy, strengthening weak institutions and the rule of law, and promoting economic growth. The new Paraguayan government has indicated its interest in reversing Paraguay's long-standing objections to U.S. positions in the WTO. Your visit demonstrates broad U.S. interest in the bilateral relationship and support for the Paraguayan government at a critical moment in the country's history.  
END SUMMARY.

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LOCAL AND REGIONAL POLITICS  
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¶12. (C) Fernando Lugo's administration represents the first interruption in Colorado Party rule in 61 years, and as such, it is shaking the foundations of Paraguayan society. Former Catholic bishop Fernando Lugo won 40.8 percent of the vote in April national elections. His Patriotic Alliance for Change (APC), a loose coalition of political parties, won a large block of seats in Congress but does not have a majority. By voting overwhelmingly for change, the Paraguayan people gave Lugo a mandate for political, economic, and social reform. However, they also have high short-term expectations. Since his August 15 inauguration, Lugo has assembled a diverse team of politicians and technocrats to serve in his cabinet; he has encouraged each of his ministers to implement a 100-day plan to show the Paraguayan people that his government is making progress.

¶3. (C) Just on the heels of President Lugo's October 27 meeting with President Bush in Washington, your visit offers the United States an opportunity to reaffirm its interest in Paraguay, particularly on trade issues. During their hour and a half-long meeting, President Bush expressed his commitment to support health, education, and economic development in Paraguay. The President announced an additional USD 10 million in U.S. assistance over the next year for health initiatives and economic development.

President Bush also applauded Lugo's anti-corruption efforts, which will be supported by Phase Two of the Millennium Challenge Corporation's Threshold Program. Paraguay submitted its Stage Two Threshold proposal September 30, with great interest and support from Lugo and his economic cabinet. The proposal is now being reviewed by the Millennium Challenge Corporation. President Bush also recognized Lugo's commitment to fighting drug trafficking.

¶4. (C) We believe Lugo is a leftist at heart, but a pragmatist of mind. Lugo has acknowledged the Washington-Caracas tug-of-war, and has said he is not Chavez, and will not blindly follow Chavez' Bolivarian ideas. Lugo told Ambassador October 9 that international relations are between countries, not specific individuals, and are based on mutual respect and independence. (NOTE: Lugo made similar comments privately to President Bush and in his subsequent White House press conference October 27. During the meeting with President Bush, Lugo also highlighted his interest in the Uruguayan model as an appropriate approach for Paraguay. END NOTE). Lugo appears to be determined to steer his own course, but will likely be sensitive to attempts to strong-arm Paraguay or to undermine its independence or sovereignty, whether by Venezuela or the United States. Lugo appears to have played a helpful role in Union of South American Nations (Unasur) talks on Bolivia, and is developing constructive relationships with Uruguay, Chile and Colombia. He visited Washington for the first time in May 2007, and traveled to New York for the United National General Assembly (UNGA). Lugo has traveled extensively since his April election.

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AN UPHILL BATTLE  
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¶5. (C) Lugo's challenges are many: His inexperienced team needs to meet Paraguayans' high expectations for change, but will have to overcome endemic corruption, weak institutions, and a divided Congress to do so. He faces continued criticism related to President Chavez' attempts to meddle in domestic politics. Lugo does not have his own political party, and has distant (at best) relations with his Liberal Party Vice President, Federico Franco. His own inner circle continues to jockey for power and ideological influence. So far, Lugo has weathered the minor storms he has faced, but he has yet to develop a clear national agenda, or to engage in the political brokering which will be critical to his administration's success. A more in-depth discussion of some of Lugo's challenges follows.

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THE ECONOMIC REALITY  
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¶6. (SBU) Lugo must promote economic development while cutting the bloated Paraguayan state. Agriculture represents 21.9 percent of gross domestic product (GDP), and the economy is heavily dependent on exports of soybeans, cotton, grains, cattle, timber, sugar, and electricity. More than 250,000 families depend on subsistence farming activities and maintain marginal ties to the larger productive sector of the economy. Paraguay boasts vast hydroelectric resources, including the massive Itaipu hydroelectric dam built and operated jointly with Brazil, but fails to capitalize on those resources. The new government welcomes foreign investment, but widespread corruption and a weak judicial system are deterrents to investment. Paraguay's real GDP in 2007 was USD 12.8 billion (in 2000 dollars), with a

per-capita GDP (purchasing power parity) of USD 4,000 in current U.S. dollar terms in 2007; inflation in 2007 was 6.0 percent, down from 12.5 percent in 2006. In addition to retail, banking, and professional services, there is significant commercial activity involving the import of goods from Asia and the United States for re-export to neighboring countries. The underground economy, which is not included in the national accounts, probably equals the formal economy in size.

¶ 7. (U) The domestic labor force included an estimated 2.73 million workers in 2006. Total unemployment for 2006 officially stood at 11.4 percent, up from 9.4 percent in 2005. Total underemployment for 2006 stood at 24.0 percent, down from 25.1 percent in 2005. With a population growth rate above two percent annually, a key challenge is the creation of enough jobs to meet increasing demand. While the supply of workers is relatively large and growing, experts cite the lack of a skilled work force as an obstacle to economic growth.

¶ 8. (U) Bilateral trade with the United States has increased over the last six years. Although U.S. imports from Paraguay were only USD 68 million in 2007, up from USD 58 million in 2006, U.S. exports to Paraguay in 2007 were USD 1.2 billion, up from USD 910 million in 2006. More than a dozen U.S. multinational firms have subsidiaries in Paraguay, and some 75 U.S. businesses have agents or representatives in Paraguay. Cargill, ADM, Coca Cola and Exxon Mobile are the largest U.S. companies operating in Paraguay. As of March 2007, the total foreign direct investment in Paraguay stood at USD 1,602.52 million. The United States was the largest foreign investor in Paraguay, with USD 616.50 million, followed by Brazil with USD 230.85 million. Foreigners invested a total of USD 110.98 million in Paraguay in 2006, up from USD 34.79 million in 2005. The largest foreign investors in 2006 were the United States with USD 67.37 million, followed by Brazil with USD 31.10 million.

¶ 9. (U) Paraguay has inefficient state-owned monopolies in the rail, oil and gas, cement, steel, electricity, water, and telephone service industries. Political realities render outright privatizations of state-owned enterprises unlikely in the short term, although Lugo's economic team is discussing public-private partnerships to reform state-owned enterprises. The large state-run companies most attractive to foreign buyers (such as the telecom and electricity distribution companies) employ thousands of potential voters and are outlets for political patronage.

¶ 10. (SBU) Paraguay and the United States annually discuss investment and commercial issues via the Joint Council on Trade and Investment (JCTI). Key trade and investment issues in the last JCTI, held in December 2007, included U.S. certification of Paraguayan beef; technical assistance and investment in biofuels; FDA approval of Paraguay's natural sweetener stevia, and Paraguay's request to be given preferential U.S. treatment such as under the Andean Trade Preference and Drug Eradication Act (ATPDEA). As the Commerce Minister likes to say, "we seek trade, not aid." In 2006, Paraguay entertained the idea of a Bilateral Trade Agreement (BTA), but efforts stalled because Paraguayans believed they were not ready. Post has not receive any further formal expressions of interest in a BTA, but the new government has provided strong indications of its interest in reversing its objection to U.S. trade preference programs in the WTO, which would open the door for future trade discussions. (NOTE: The next WTO meeting on this issue is November 18. END NOTE).

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PUBLIC SECURITY AND SOCIAL ISSUES  
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¶ 11. (SBU) Security and social issues are top concerns of Lugo's constituents. Violent crime is increasing in urban and rural areas, and the public generally believes that Paraguayan security forces (particularly the corrupt police)

do not meet their security needs. The "landless" farmer movement has increasingly taken to protesting and "land invasions" -- illegally occupying large, privately-held ranches -- in agitating for agrarian reform. On some occasions, protests and "land invasions" have resulted in deaths or injuries.

**¶12. (C)** The Tri-Border Area (TBA) of Paraguay, Argentina and Brazil is a hub for trans-national criminal activity including drug trafficking, trafficking in persons (TIP), arms trafficking, intellectual piracy, and money laundering. Paraguay is a major transshipment point for cocaine from Colombia and Bolivia to Brazil; it is the top marijuana producer in South America, and Paraguay remains a regional haven for money laundering. Paraguayan authorities often experience difficulties enforcing the law because of hostile geography, corruption, chronic understaffing, and the political and judicial power some drug traffickers wield. Paraguay took a giant step forward on money laundering, intellectual property violations, and trafficking in persons by passing a tougher penal code in June that will go into effect next year. Like his predecessors, Lugo is sensitive to "satanizing" the TBA, but has sent some promising signals by mentioning the need to eradicate terrorism during his speech at the UNGA, and by signing agreements with Colombian President Uribe to promote collaboration in that area.

**¶13. (SBU)** Inefficient, state-run institutions dominate Paraguayan social services, and Lugo pledged to improve social services spending and make health care and education reform government priorities. Social services spending increased since 2003; however, most spending augmented employees' salaries. Many Paraguayans lack basic access to health care facilities, particularly in rural areas, and many more are uninsured. Government agencies and state-owned enterprises provide basic public services, but access is limited and services have deteriorated in quality.

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#### LUGO'S GOALS AND U.S. ASSISTANCE TO PARAGUAY

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**¶14. (U)** Lugo's goals are to strengthen democratic institutions, fight corruption and informality, create a professional civil service, and promote economic growth. Reforming the National Police and land reform, including a national land survey, are also priorities. He promised improved social services and to promote a "social justice" agenda. Lugo and several key ministers told the Ambassador October 9 that his government is interested in discussing commercial issues (particularly beef and stevia) and economic development with the United States. This broader trade relationship was again repeated in the October 27 Bush/Lugo meeting.

**¶15. (U)** U.S. assistance in Paraguay supports many of Lugo's goals. USAID/Paraguay's FY08 budget is USD 7.8 million and focuses on Economic Growth; Improved Health Care; Sustainable Management of Natural Resources and Protected Areas; and Democratic Strengthening. USAID's Economic Growth Program ("Paraguay Vende") has generated over USD 60 million in additional sales and over 30,000 full-time job equivalents since 2003, thus supporting Lugo's goal to reduce poverty. Likewise, USAID's Health Program supports Lugo's stated interest in improving basic health services. Specifically, it targets decentralizing health services, improving maternal and child care services, and increasing Paraguay's capacity to deliver family planning services. In the environment sector, USAID continues to support improved management of protected areas. The Democracy Program focuses on fighting corruption, giving civil society a voice, and promoting decentralization and municipal development. Additionally, Paraguay's Millennium Challenge Account Threshold Program has provided USD 35 million over the past two years in an effort to fight corruption and formalize Paraguay's economy.

**¶16. (U)** The Embassy's leading public diplomacy effort is its English language scholarship program, which identifies academically outstanding young Paraguayans from families with

limited resources. Since the program's inception in 2006, the Embassy has awarded over 500 scholarships. USG support for the Paraguay Military Forces is second only to our support for Colombia in South America. One highlight is the U.S. Armed Forces' USD 4.1 million donation of Global Peace Operations Initiative (GPOI) funds and technical assistance to Paraguay's United Nations Global Peace Keeping Operations Program (UNPKO). Other security funding includes State's International Narcotics and Law Enforcement (INL) money, which along with DEA and U.S. Special Forces, assists Paraguay's Anti-Drug Secretariat (SENAD) in combating narcotics trafficking, money laundering, IPR violations, and trafficking in persons.

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PRESIDENT RUTHERFORD B. HAYES MEMORIAL  
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¶17. (U) Following the War of the Triple Alliance (1864-70), Argentina occupied a large portion of the Chaco, Paraguay's western region. Paraguay and Argentina asked the United States to rule on ownership of the occupied territory, and on November 12, 1878, U.S. President Rutherford B. Hayes decided in favor of Paraguay. Paraguay named the territory "Presidente Hayes" and its capital, Villa Hayes, in honor of Hayes. This year marks the 130th anniversary of Hayes' decision, and your visit will include a brief stop in Villa Hayes to attend Presidente Hayes' 130th anniversary celebration. Along with the Ambassador, you will rededicate the President Rutherford B. Hayes Elementary School, refurbished this year with U.S. assistance, and donate books to the school. The Paraguayans consider Hayes a national hero, and your visit will help reaffirm our long-time friendship with Paraguay.

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COMMENT  
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¶18. (C) Lugo's meeting with President Bush sent a strong signal regarding his desire for close relations with the United States and his intent to steer a neutral course for Paraguay. If we are to continue to make in-roads with President Lugo, visits such yours are critical to convincing him that he can count on the United States. More so than any other president in modern Paraguayan history, Lugo has an opportunity to affect real change. However, the deck is stacked against him. We have an opportunity to forge a close relationship with Paraguay at a moment when there is growing anti-American sentiment in much of South America. Lugo told Ambassador October 9 that the United States has a breadth of experience that Paraguay could learn from, in spite of the U.S.'s "own shadows." The meeting between Presidents Bush and Lugo October 27 re-affirmed our long-term relationship and highlighted the need for a broader commercial/trade agenda. Your interest in Paraguay demonstrates broad U.S. interest in the bilateral relationship, and support for Paraguay's pragmatic president at a critical moment in the country's history. END COMMENT.

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